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ABSTRACT

This pamphlet summarizes the legal restraints that affect the right of colleges and universities to withhold transcripts as a means of collecting student debts under the Bankruptcy Code of the United States which provides for restraint on the actions of creditors. An introductory section notes that there are three kinds of relevant bankruptcies (Chapter 7, Chapter 11, and Chapter 13) and three sets of provisions of the Bankruptcy Code which affect the right to withhold transcripts: (1) the automatic stay provisions, which state that the filing of a petition for bankruptcy acts as a prohibition of actions to collect on obligations of the debtor; (2) the discharge injunction, which provides that once a discharge of debts has been granted, further actions to collect them are barred; and (3) the anti-discrimination clauses which prevent public entities and some private entities from denying various privileges to persons seeking bankruptcy protection. Each of these three sets of provisions are explained more fully in the following sections. A summary suggests rules for institutions to follow in making the decision to withhold a transcript. These rules focus on the importance of the exact status of the bankruptcy action. (CK)

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# The Permissibility of Withholding Transcripts Under Bankruptcy Law

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# The Permissibility of Withholding Transcripts Under Bankruptcy Law

## Introduction

The United States Congress has exercised its constitutional power to provide for uniform laws of bankruptcy, thereby permitting federal courts to intervene in what are essentially matters of state law. The Bankruptcy Code provides for restraint on the actions of creditors to ensure the integrity of bankruptcy law. Those restraints that affect the right of colleges and universities to withhold transcripts as a means of collecting student debts are the topic of this pamphlet.[1]

The purpose of bankruptcy law is to seek the fairest possible adjustment between over-extended debtors and their creditors. Bankruptcy law requires debtors to distribute their property or income, except living necessities, to their creditors. To the extent that debts are not paid off through distribution, they may be discharged. The effect of discharge is that the claim for the debt is no longer legally enforceable.

There are three kinds of bankruptcies relevant here: chapter 7 bankruptcies, in which the non-exempt property of the debtor is liquidated and the proceeds are distributed among the creditors; chapter 11 bankruptcies, in which the debtor's financial affairs are reorganized under a court-approved plan; and chapter 13 bankruptcies, under which debtors with regular income devote a portion of their income to paying debts, also within a court-approved plan.

Three sets of provisions of the Bankruptcy Code affect the right to withhold transcripts. The first are the automatic stay provisions[2],

1. Users of this pamphlet should be aware that the advice given here is general in nature. The specific facts of your case and the specific jurisdiction in which the case arises may affect the choice of legal alternatives. Your legal counsel should be consulted for specific advice.

2. §362(a)(6), and in chapter 13 bankruptcies, §1301. References to sections are to the 1978 Bankruptcy Code as amended, Title 11, United States Code.

which state that the filing of a petition for bankruptcy acts as a prohibition of actions to collect on obligations of the debtor. The second, the discharge injunction, provides that once a discharge of debts has been granted, further actions to collect them are barred.[3] Finally, the anti-discrimination clauses prevent public entities, and, in some respects, private entities, from denying various privileges to persons seeking bankruptcy protection.[4] Together these provisions forbid the withholding of transcripts during the pendency of a bankruptcy action and afterward if all debts have been discharged. However, if debts are not discharged, withholding transcripts is permissible once the bankruptcy action is final.

## Prohibition of Withholding Transcripts During the Pendency of a Bankruptcy Proceeding: The Automatic Stay

Bankruptcy restrictions on the actions of creditors begin with the filing of a bankruptcy petition. The filing of a petition for bankruptcy operates as an automatic stay and prohibits the creditor from taking any action to recover a claim against the debtor.[5] In addition, if the debtor has filed under chapter 13, actions to collect a consumer debt from a codebtor are prohibited, even though the codebtor has not sought protection under bankruptcy law.[6] A consumer debt is one "incurred by an individual primarily for a personal, family or household purpose."[7]

Creditors should receive formal notice of the bankruptcy petition and stay from the court soon after the case begins. However,

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3. §524(a)(2).

4. §525.

5. §362(a)(6).

6. §1301. A codebtor is a person who is liable with the debtor or who secured the debt. Thus, if parents take out an educational loan for a student and the student is a co-maker or guarantor, a chapter 13 petition filed by the parents may stay actions to recover from the student.

7. §101(8). The terminology derives from consumer protection law. At least one court has ruled that a loan used for business training is not a "consumer debt" as contemplated by §1301. *In re Chrisman*, 27 B.R. 648 (Bankr. S.D. Ohio 1982). However, that case presented unusual circumstances; in most situations, education loans would be treated as consumer debt.

even if no formal notice is received, but the creditor is made aware through other channels that a petition has been filed, no collection action should be taken. Often debtors themselves will inform creditors that a bankruptcy petition has been filed. Because the stay is in effect regardless of whether formal notice of it has been received, it is wise not to treat such information casually.

The purposes of the stay are to provide breathing room for the debtor and to assure fair treatment among creditors. To effectuate these goals, courts tend to interpret the stay provisions broadly. The stay provisions prohibit withholding transcripts during a bankruptcy proceeding unless the court has lifted the stay.

It is well established under the 1978 Bankruptcy Code that refusal to release transcripts violates the stay.[8] An older case holding that withholding transcripts was permissible under the 1898 Bankruptcy Act was legislatively overruled by the new code.[9] Violation of the stay could subject the institution to payment of damages, attorneys' fees and, in egregious cases, punitive damages.[10]

The court may grant relief from the stay against the debtor; however, in ordinary circumstances, it is unlikely the education creditor would be able to establish cause for relief.[11] Relief from the codebtor stay in chapter 13 cases is more easily obtained. The creditor

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8. *E.g., In re Merchant*, 958 F.2d 738 (6th Cir. 1992); *In re Gustafson*, 111 B.R. 282 (9th Cir. BAP 1990), *rev'd on other grounds*, 934 F.2d 216 (9th Cir. 1991); *In re Parham*, 56 B.R. 531 (Bankr. E.D. Va. 1986); *In re Reese*, 38 B.R. 681, 683 (Bankr. N.D. Ga. 1984).

9. In *Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977), the court held that section 32(f)(2) of the 1898 act did not prevent non-judicial attempts to collect on obligations. See *Parham*, 56 B.R. at 532-3 for a discussion of the reasons for concluding that *Girardier* was overruled.

10. §362(h). *But see In re Gustafson*, 934 F.2d 216 (9th Cir. 1991) (holding that the Eleventh Amendment precludes recovery of attorney fees as monetary sanctions from a state university for willful refusal to release transcripts), overruling 111 B.R. 282 (9th Cir. BAP 1990).

11. *See* §362(d). One court has observed that "withholding the debtor's transcript is arguably counterproductive to the creditor's desire to be paid and the debtor's need to obtain the additional training and/or employment necessary to enable the debtor to pay the presumptively nondischargeable student loan." *In re Gustafson*, 111 B.R. 282, 286, n.3 (9th Cir. BAP 1990), *rev'd on other grounds*, 934 F.2d 216 (9th Cir. 1991).

may gain relief from the stay as against the codebtor to the extent that the codebtor was the recipient of the college's services, to the extent that the debtor does not plan to pay all of the debt or where the college is likely to suffer irreparable harm.[12] Without positive action from the court, the stay lasts until the case is closed, dismissed or a discharge is granted or denied, whichever occurs first.[13] The stay could remain in effect for years. For example, a chapter 13 plan may extend as long as five years.[14]

## Post-Discharge Restrictions on Withholding Transcripts: The Discharge Injunction

If the debtor has been discharged from all debts owed to a creditor, the discharge injunction[15] prevents any action to recover those debts. The injunction is worded broadly enough to prohibit the withholding of transcripts as an act to collect a discharged debt. Therefore, it is important to determine first whether the debtor has been discharged from debts owed to the education creditor.

As a general matter, certain debts owed to education creditors are not discharged by a general discharge order. Those include debts for educational benefit overpayments, loans and obligations to repay funds received as an educational benefit, scholarship or stipend that are made, insured or guaranteed by public or nonprofit agencies or institutions unless the debt first became due more than seven years before the bankruptcy petition was filed.[16] Also exempted from discharge are fines levied by governmental units that are not in the nature of compensation for loss.[17]

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12. §1301(c) and (d). *See In re Brown*, 12 B.R. 885 (Bankr. N.D. Ga. 1981) (codebtor stay does not prevent withholding transcript of student whose parents had filed a chapter 13 bankruptcy because the daughter received the benefit of the education).

13. §362(c). The codebtor stay lasts until the case is closed, dismissed, or converted to a chapter 7 or 11 case. §1301(a)(2).

14. §1322(d).

15. §524(a)(2).

16. §523(a)(8).

17. §523(a)(7).

However, debts to colleges and universities other than educational loans or fines are ordinarily not exempt and therefore are included in the general discharge. Examples might include debts for University-provided goods and services, such as medical treatment or pharmaceuticals, or library charges for lost or unreturned books.

One must first analyze whether the debt is of the kind excepted from discharge and then determine whether the debt, nonetheless, has been discharged. One should obtain a copy of the order of discharge and ascertain if any other orders have been entered in the case with respect to the dischargeability of debts. Absent any orders specific to the education debt, a general discharge order will not affect debts of the kind described in the paragraph above.[18]

Under prior law, completing a chapter 13 plan that included education debts would have discharged such debts.[19] However, due to 1990 amendments, educational debts excepted from discharge are now treated the same whether the debtor is discharged under chapter 13 or chapter 7.[20]

The discharge injunction states that a discharge under the Bankruptcy Code operates as a bar against any act to collect, recover or offset the discharged debts against the debtor.[21] Refusal to permit students to order or gain access to official transcripts after discharge of all debts clearly violates the discharge injunction.[22] The argument that refusal to release

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18. It is impossible to adequately cover in this brochure the complex issues surrounding dischargeability. Initially, some courts and commentators expressed uncertainty on whether a general discharge affects education debts, and whether an education creditor is required to obtain a court's determination on specific debts before commencing post-discharge collection activity. *See* Ayers and Sagner, "The Bankruptcy Reform Act and Student Loans: Unraveling New Knots," 9 *Journal of College and University Law* 361 (1982). However, it is now clear that the exception from discharge provided in §523(a)(8) is self-executing and that the education creditor is not required to file a complaint to determine dischargeability. *See Buford v. Higher Educ. Assistance Foundation*, 85 B.R. 579 (D.C. Kan 1988) and the cases cited there at 581.

19. Former §1328(a).

20. *See* P.L. 101-508 §3007, November 5, 1990, as amended by P.L. 102-325 July 23, 1992, §1558.

21. §524(a)(2).

22. *Parraway v. Andrews University*, 50 B.R. 316 (W.D. Mich. 1984).

transcripts is not an action, but a failure to act has been rejected.[23] Congress intended this section to ensure that the debtor "will not be pressured in any way" to repay discharged debts.[24] Creditors who engage in efforts to collect on discharged debts subject themselves to possible fines and findings of contempt of court.[25]

It should be no surprise that the Bankruptcy Code prohibits withholding of transcripts if debts to the education creditor are discharged. The purpose of a discharge is to grant a fresh start to the debtor free of the burdens of the discharged debts. Since withholding transcripts affects the ability to gain further education and employment, courts will take a dim view of such a tactic.

## The Anti-Discrimination Provisions of the Bankruptcy Code

Section 525(a) of the Bankruptcy Code provides that *governmental units* may not "deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or similar grant to...or discriminate with respect to employment against" someone solely because he or she has filed for bankruptcy or received bankruptcy relief. Section 525(b), added in 1984, provides that *private entities* may not discriminate against bankruptcy debtors with respect to employment. These provisions apply any time after the filing of a bankruptcy action and even after discharge. There are cases holding that the anti-discrimination clauses prevent withholding of transcripts by public institutions during the pendency of a case.[26] There are also cases under prior law prohibiting public colleges and universities from

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23. *Lanford v. Macalester College*, 10 B.R. 132 (Bankr. D. Minn. 1981). *See also Juras v. Aman Collection Service, Inc.*, 829 F.2d 739 (9th Cir. 1987), *cert. denied*, 488 U.S. 875 (1988) [Outside of bankruptcy, withholding of debtor's transcript is a reasonable enforcement mechanism and is not an unfair collection practice prohibited by 15 U.S.C. §1692(f)].

24. House Report No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977), p. 366.

25. *In re* Myers, 18 B.R. 362 (Bankr. E.D. Va. 1982). *But see* note 10 *supra*.

26. *E.g., In re Reese*, 38 B.R. 681, 683 (Bankr. N.D. Ga. 1984).

discriminating against students whose debts were discharged by withholding their transcripts.[27] Although it remains unresolved whether private institutions are prevented from withholding transcripts by section 525(b), resolution of that issue is unnecessary. The stay provisions preclude withholding during the pendency of a bankruptcy action, irrespective of whether or not the debt is exempt from discharge. The discharge injunction prevents withholding after discharge of the debt.

The important question, then, is whether the anti-discrimination provisions affect withholding of transcripts when the case is no longer pending and where the educational debt had not been discharged. The answer is that they do not.

A federal appeals court has ruled that withholding a transcript did not violate section 525(a) where the student had received a general discharge, but one that did not affect student loan obligations.[28] The court noted that Congress had exempted student loans from discharge in certain cases to prevent bankruptcy law from damaging the integrity of student loan programs. The court concluded that section 525 did not prevent withholding transcripts as a means of collecting *undischarged* student loans.

Although there are especially strong reasons for permitting actions to collect educational loans when they have not been discharged, any non-discharged debt should be enforceable and therefore collectible by the creditor. Thus, it is generally permissible to withhold transcripts whether or not the surviving debt is an educational loan.

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27. *Handsome v. Rutgers University*, 445 F. Supp. 1362 (D.N.J. 1978); *Lee v. Bd. of Higher Ed.*, 1 B.R. 781 (S.D. N.Y. 1979). These cases are probably still valid. Section 525 was originally enacted in 1978 to codify the holding in *Perez v. Campbell*, 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233 (1971). House Report No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977), p. 366. *Perez* held that a state could not refuse to reinstate the license of a driver solely because the driver had not paid a discharged judgment arising out of an automobile accident. Before section 525 became effective, *Handsome* and *Lee* relied on *Perez* in holding that withholding of transcripts was impermissible.

28. *Johnson v. Edinboro State College*, 728 F.2d 163 (3rd Cir. 1984).

**Summary**

There are three rules to follow when dealing with the question whether to withhold transcripts of a bankruptcy debtor. The first is that a transcript should not be withheld during the pendency of a bankruptcy action without obtaining relief from the stay. The second is that if a discharge of all debts has been granted to the debtor, schools should not withhold transcripts. The third is that it is permissible to deny transcripts where the case is no longer pending before the court and educational debts were not discharged, especially if the underlying obligation is a student loan.

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